

CHAPTER 6

Regional and Multilateral Trade Agreements

The United States has participated with other nations in the eight rounds of multilateral trade negotiations since the inception of the General Agreement on Tariffs and Trade (GATT) in 1948. The main principles of the original agreement are the first part of this chapter. This section reviews Uruguay Round accomplishments related to trade and foreign direct investment in processed foods. While Vaughan et al. (1994) found in their interviews that government policies were not the major factor in most of the firms' decisions on the method of entering a foreign market, international trade rule changes are likely to boost both trade and foreign direct investment in the processed foods industries.

The 117 GATT members completed the latest round of negotiations, the Uruguay Round, in December 1993. The signing was in April 1994, the agreement was ratified by the United States and other members of GATT, and it became effective on July 1, 1995. One of the most visible results of the Uruguay Round agreement was the transformation of the General Agreement (treaty) among nations known as contracting parties, into a full-blown international institution, the World Trade Organization (WTO). This chapter deals with the aspects of WTO rules that pertain to processed foods trade. For the sake of consistent terminology, the discussion refers to the WTO to mean either the WTO per se or to the GATT.

In addition to multilateral negotiations, the United States has completed complementary regional trade agreements: U.S.-Canada, U.S.-Israel, and the North American Free Trade Agreement (NAFTA). Of the three, the NAFTA among the United States, Canada, and Mexico is the most significant because the U.S.-Canada agreement is subsumed in it and the U.S.-Israel agreement covers a smaller amount of trade. The NAFTA negotiations began after the start of the Uruguay Round and finished before its conclusion. This shaped NAFTA to the extent that

negotiators did not want provisions that would lead to direct conflict with provisions of the anticipated multilateral agreement.

WTO Principles

The primary principles of the WTO are most-favored nation (MFN) and national treatment, which were Article I and Article III, respectively, of the original agreement. A third principle, transparency, has grown over time and is quite important to processed foods trade, especially for products of limited shelf life. The general statement of MFN requires that “goods of any contracting party be given no less favorable treatment than that given any other contracting party” (Jackson, 1969 p.255). MFN prevents, for example, the United States from giving Germany import preferences over the United Kingdom. The idea is to create a liberal trading environment that avoids creating trade distortions. Regional trade agreements are an exception to MFN, allowing trade preferences within a trade agreement that includes substantially all trade. MFN does allow for preferential treatment of developing countries, the best example being the special access granted by the European Union under the Lomé Convention to a designated list of African, Caribbean, and Pacific nations growing out of former colonial status.

National treatment obliges countries to give the same treatment to imported products that have cleared customs as is given to domestic goods. Taxation and regulation are two obvious areas that could be abused. Jackson’s examples are apt: “An internal tax can be a protectionist substitute for a tariff if it discriminates against imported goods. Likewise, internal government regulations can operate to protect domestic goods—e.g., a ban on the internal sale of an imported product is more effective than a tariff in keeping the product out of a market. Subtle devices, such as labeling and packaging requirements, and special “health” or purity regulations applying only to imports can operate in the same manner.”

National treatment confers obligations on national governments, which must ensure that State and local governments also do not discriminate against imported goods. Local products may be

avored or disfavored by business practices and consumer preferences, but these are not subject to WTO rules.

Transparency is a general requirement that a country make available to foreign companies and governments the requirements and changes in requirements for access into the country. The transparency requirement attempts to improve predictability and steadiness in import requirements. For processed foods, the importance of transparency is obvious. If a shipment of frozen food with a definite shelf life is met at the border by customs agents who reject the shipment because of new requirements for a license, a different label or a different package, or reinspection of the plant that produced the product, the exporting company may suffer losses due to spoilage or delay. Transparency essentially requires that there be no hidden barriers or changes in import requirements without notice.

The exemptions to the basic obligations under WTO rules are contained in Article XX, which allows countries to use measures to protect public morals or to protect human, animal or plant life or health, etc., so long as the measures are not employed in an arbitrary or discriminatory manner. The Uruguay Round agreement clarifies, as discussed below, that such measures must have a scientific basis and rest on appropriate risk analysis.

Uruguay Round Agreement

Four of the fifteen sections of the Uruguay Round Agreement deal with technical barriers to trade (TBT), trade-related investment measures (TRIM's), trade-related intellectual property issues (TRIP's), and sanitary and phytosanitary standards (SPS). These impact directly on international commerce in processed foods. In combination with a stronger dispute settlement mechanism in the World Trade Organization, the strengthening of rules on TBT, TRIM's, TRIP's, and SPS should yield trade expansion and potentially alter decisions on whether to enter foreign markets through FDI or trade. TBT and SPS are touched on lightly here but are addressed in detail in chapter 7. In addition to the areas above,

the Agreement on Agriculture is important to the processed-foods industries.

Technical Barriers to Trade (TBT)

The Agreement on Technical Barriers to Trade (i.e., Standards Code) was initiated in the Tokyo Round (1973-1979), setting out principles that were strengthened in the Uruguay Round. The main drawback to the Standards Code before the Uruguay Round Agreement was that it had no binding enforcement mechanism. The establishment of the Dispute Settlement Body in the Uruguay Round is intended to remedy this shortcoming. The Uruguay Round also brought process standards under the TBT agreement, whereas the Tokyo Round covered only product standards.

The TBT agreement deals with such areas as packaging and labeling requirements, inspection, and certification procedures in order to protect the public and avoid deceptive practices. It encourages countries to adhere to international standards when such standards already exist, to publish their standards, and to base standards on scientific evidence and appropriate risk assessment.

Trade-Related Investment Measures (TRIM)

The TRIM agreement applies only to investment measures related to trade in goods. There appears to be little that is new in the TRIM Agreement that applies to FDI or trade in processed foods. The TRIM Agreement applies mainly to imports tied to re-exports in terms of value, foreign exchange, or quantity and to laws on local manufacture, local content, or local equity in the firm.

Sanitary and Phytosanitary Standards (SPS)

The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) applies to human, animal, and plant health and safety arising from diseases, pests, additives, contaminants, and toxins. As with the TBT agreement, the SPS rules encourage the development and use of harmonized international standards to facilitate trade. The SPS agreement names the Codex Alimentarius

Commission, the International Office of Epizootics, and the International Plant Protection Convention as the international standards agencies. In cases of different standards in two countries, the importing country is required to accept the exporting country's standard if the exporting country demonstrates the equivalence of its own standard. In other words, the importing country accepts the product if the sanitary or phytosanitary protection afforded by its scientifically based standard is met by a different procedure in the exporting country.

National agencies, such as the U.S. Food and Drug Administration (FDA), specify how foods must be treated in processing (e.g., at what temperature and for how long) to ensure that diseases and microbes are not viable in the food product. The question of what rules are adequate without being too restrictive gives rise to differing interpretations of SPS rules for processed foods. The second reason why SPS rules may apply to processed foods is the degree of processing. For instance, fresh packaged seafood is considered processed even if little or nothing has been done to ensure that the seafood is not contaminated.

Trade-Related Intellectual Property Issues (TRIP's)

The main provisions of the TRIP's agreement deal with patent and copyright protection, which apply to branded food products. The agreement builds on existing institutions including the World Intellectual Property Organization (WIPO), a U.N. agency founded in 1967. The agreement establishes minimum standards to which countries must adhere. Alleged violations are subject to the WTO Dispute Settlement Body. The most obvious ways that international commerce in the food sector is facilitated by TRIP's are in brand protection, geographical indications, and protection of proprietary information such as processing technology and recipes.

The TRIP's agreement protects food brands in the same way as for the more publicized cases of software piracy or counterfeit clothing. A company such as Kellogg's, for instance, does not want another company offering Kellogg's Corn Flakes in any country because immediate profits may be lost and because Kellogg's reputation for

quality may be injured if the other company's product is inferior. The TRIP's agreement protects brand names by including seven articles on trademarks, which are renewable indefinitely.

"Geographical indications" (also known as denomination of origin) is a contentious area. The product label must say where the product originates and may not present itself in a misleading manner, e.g., a soy sauce boldly proclaiming Canton Soy Sauce should be from Canton Province in China rather than from Canton, Ohio. Perhaps the best known example of geographic indications is the case of champagne. France insists that only sparkling wine produced in the Champagne region of France can be properly known as champagne. Some other countries counter by saying that champagne is a type of product produced in many places, but known everywhere as champagne. Some countries and firms accept that the name belongs to a specific region of France and that sparkling wine from other places should be designated with "methode champenoise" if it is made by the same process used in France. The principle is established in WTO rules, but its impact will only be clear as precedents are established through case-by-case settlement of disputes.

The requirement to disclose proprietary information is a means used by some countries to acquire technology or formulas that have been developed elsewhere. This distorts firms' decisions on how best to enter a foreign market, i.e., whether to export a product or invest and produce it in the destination country. For example, a beverage company may prefer to manufacture in the destination country because it would not be paying to transport water. A company such as Coca Cola may decide to export if the destination country requires that the formula for Coca Cola be disclosed to the government of the destination country. The TRIP's agreement protects proprietary information by requiring member countries to keep secret any information of commercial value that is submitted to the government in order to gain approval for marketing.

Agreement on Agriculture

The Agreement on Agriculture has been discussed thoroughly elsewhere (Josling 1994, USDA 1994B, and Hathaway and Ingco 1995), but the main outlines and implications for processed foods bear mentioning. The Agreement on Agriculture is important to the processed foods industries because it applies to many processed products that are traded in bulk after a first stage of processing. For instance, grain mill products such as, soybean meal, corn gluten feed, wheat flour, and vegetable oils fit in SIC-20 (Food and Kindred Products) rather than SIC-10 (Agricultural Products).

The main outcomes of the Uruguay Round Agreement on Agriculture were (1) a reduction in export subsidies by 21 percent in volume (tonnage) terms and by 36 percent in terms of expenditures; (2) a commitment to improve import access by reducing existing tariffs, maintain current access opportunities, and expand import opportunities where access was low or non-existent; and (3) a reduction of 20 percent in the Aggregate Measure of Support (AMS), the trade-distorting agricultural support programs overall, not commodity by commodity. The disciplines imposed by the agriculture agreement reduce governments' scope for distorting trade in food and agricultural products. In addition to liberalizing trade, the agreement creates an incentive for countries desiring protection to use other means including product and process standards.

Dispute Settlement

The Dispute Settlement Body (DSB) was created in the Uruguay Round to provide a stronger means of settling disputes than had existed before. Until the implementation of the Uruguay Round agreement, the defending party could deny the GATT jurisdiction, avoid timely settlement, and block adoption of dispute settlement rulings.

Now, a member is required to enter consultations within 30 days when another member brings a complaint to the WTO. If there is no resolution 60 days after the complaint is registered, the member bringing the complaint can ask for a panel to consider the complaint. If the parties to the dispute cannot agree to membership of the panel,

the Director-General appoints a panel. A timetable is laid out, including an appeals process if necessary, that leads to resolution within 14 months of the original complaint. If a member succeeds in the dispute and the losing party refuses to implement the decision, the winner is entitled to compensation or to withdraw concessions.

Adequate enforcement changes the behavior of firms and institutions. In the case of NAFTA, Mexico wanted to improve access to the U.S. market for its avocados. USDA's Animal and Plant Health Inspection Service (APHIS) was reluctant to comply based on its traditional scientific procedures, which aim to prevent importation of harmful organisms. In the case of Mexican avocados, APHIS was not convinced that there was no threat from insects. APHIS is reconsidering its position with prompting from U.S. apple industry representatives, who contend that reciprocal treatment from Mexico following such a precedent could diminish U.S. apples' access to Mexico.

The dispute settlement mechanism may be the key to realizing the potential trade expansion in all the other areas of the Uruguay Round agreement. If the Dispute Settlement Body operates in a way that ensures countries can get claims addressed in a timely, impartial, predictable fashion, then countries will have to live up to their obligations agreed to in the other areas of the agreement.

A well-functioning dispute settlement system serves to make WTO agreements into enforceable contracts. Countries will be more likely to bring disputes if they think they can win on the merits of the case, as opposed to the former situation in which countries could (and did) block the formation of a dispute panel or refuse to accept the outcome. Countries may also be more likely to comply with agreements because they know that other WTO members have more certain means to have rules enforced. The resultant positive effect on trade is derived from a decrease in risk to trading companies. Part of the decreased risk derives from more predictable treatment of disputes under WTO rules.

North American Free Trade Agreement

NAFTA, the largest regional trade agreement to which the United States is a party, became effective on January 1, 1994. NAFTA is subject to WTO rules, which allow for regional trade agreements that cover substantially all trade within the region. For food and agricultural products, trade barriers among the United States, Canada, and Mexico are to be reduced and eliminated on a fixed schedule according to the type of product. Some products were deemed “sensitive” by each country, and those products were placed on a slower transition schedule. An example among processed foods is processed tomato products.

A critical provision of NAFTA for processed foods was strict rules of origin, which prevent transshipment of non-NAFTA products through one NAFTA country to another NAFTA country. For a food product to qualify for trade preference under NAFTA, a product has to be produced or substantially transformed within a NAFTA country. In other words, a product could not be imported from outside NAFTA at international prices, repackaged to show a NAFTA origin, and exported to another NAFTA country.

Some opponents to NAFTA argued that products from Mexico should not be allowed improved access to the U.S. market because Mexico has less stringent environmental controls or enforcement and lower wages. This could give Mexican products a cost-of-production advantage because Mexican companies do not have to bear the additional costs of compliance with U.S. environmental and wage regulations. The argument runs afoul of the WTO national treatment obligation, which requires that imported products be given like treatment to domestic products. Objection to Mexican (or other countries’) products on grounds of environmental or labor standards falls in the category of process standards (also known as process and production method standards), which are covered in chapter 7.

Ratification and Implementation of Trade Agreements

The process of operationalizing a trade agreement does not end with the final international negotiations. In the United States, a completed trade agreement requires implementing legislation, which amends existing law to conform with the agreement. Recent trade agreements have been negotiated under “fast track” authority, which is approval from the Congress for the Administration to negotiate an agreement that, once signed by all parties to the negotiation, will be approved or disapproved by the Congress without amendment.

In the cases of NAFTA and the Uruguay Round Agreement, the implementing legislation, although not amending terms of the agreements, carried provisions not directly related to the agreements. NAFTA had side agreements on labor and the environment. The environmental aspects are discussed in chapter 8, and the labor aspects bear some discussion here.

The necessity of a side agreement for labor stems from the fear that greater integration of markets will lead to migration of manufacturing capacity from regions with relatively high labor costs to regions with relatively low labor costs, resulting in loss of employment and downward pressure on wages and benefits in the high-cost region. In the processed foods industries, the effect differs according to the product type, but is generally unimportant. Two factors in the food industries tend to dampen effects that might be felt. First, much food processing occurs close to where the farm commodity is produced, and land is not a mobile factor of production. Second, many food products are perishable, with final processing located close to the point of consumption, and large population centers are not mobile.

Summary of Policy Implications

The Uruguay Round Agreement constitutes a major strengthening of international trade rules and liberalization of trade in goods and services. For processed foods, the main areas of the agreement are technical barriers to trade, sanitary and phytosanitary barriers, investment barriers, intellectual property protection, dispute settlement, and to some extent the agriculture agreement. As

detailed above, some of these provisions facilitate trade, and others facilitate foreign direct investment.

For trade in processed foods, the Standards Code and the SPS are stronger since the completion of the URA than they were before. As long as the Dispute Settlement Body puts real teeth into agreements in the WTO, countries should be more aggressive in challenging arbitrary and discriminatory technical barriers. Unresolved issues include the precise application of science-based technical standards and the appropriate risk assessment, the practical meaning of which will emerge as disputes arise and are settled. Further refinements of trade rules affecting trade and FDI in processed foods may be needed in the areas of competition policy and international investment.

For FDI in the processed foods industries, the Agreement on Trade-Related Investment Measures should help to liberalize investment. But in the most industrialized countries, where the bulk of FDI occurs, money already travels more readily than goods.

In the URA, the accomplishments in the trade area appear more substantial than for FDI. While FDI is the preferred strategy of processed food firms entering foreign markets, one would expect any relative shift caused by the implementation of the URA to be in the direction of trade.